New Directions for Local Government Finance:

THE NEXT STEPS

PART 2

Province of
British Columbia

Ministry of Municipal Affairs, Recreation and Culture,
Hon. Lyall Hanson, Minister

91-00466/

Province of British Columbia

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August 1990

It is my pleasure to release the second discussion paper in the series, *New Directions for Local Government Finance: The Next Steps*, Part 2 — Revenue Sharing.

This publication is the continuation of a commitment of government to review various local government finance issues that could not be addressed by immediate legislation and to provide another opportunity for public comment.

The Province participates in the financing of local government through revenue sharing to: supplement the narrow local revenue base, thereby reducing local dependence on the property tax; to reduce large disparities in the capacity of local governments to finance services; and to encourage the local delivery of services that provide benefits beyond local boundaries. Special revenue sharing accounts are also available to stabilize municipal finances. The revenue sharing stabilization account acts as a cushion against possible reductions in revenue sharing grants during periods of slow economic growth. The local government emergency account is available to stabilize municipal finances in the case of natural or local economic emergencies.

I sincerely hope that you will take time to give us your reactions to the policy options set out in this paper. Please address all correspondence to:

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Consultations with the ministry can be arranged on request.

Yours sincerely,

Lyall Hanson
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NEW DIRECTIONS FOR LOCAL GOVERNMENT FINANCE:

PART 2 — Revenue Sharing

EXECUTIVE SUMMARY

This paper reviews the Government of British Columbia's revenue sharing policies and programs related to the support of municipal government.

The province participates in the financing of local government through revenue sharing to achieve three goals: to supplement the local tax base; to reduce financial disparities among local governments; and to support the provision of services that generate benefits beyond municipal boundaries.

Special revenue sharing accounts are also available to stabilize municipal finances. The Revenue Sharing Stabilization Account acts as a cushion against reductions in revenue sharing grants during economic downturns. The Local Government Emergency Account is available to stabilize municipal finances in cases of natural or local economic emergencies.

To help the reader understand revenue sharing, the paper discusses how payments are made into the revenue sharing fund, and describes the types of payments made from the fund. Recommendations contained in the Financing Local Government Study regarding revenue sharing are then reviewed and each recommendation is discussed from the Ministry perspective.The original purposes of revenue sharing are found to hold true today and the Revenue Sharing Fund continues to be the most effective mechanism for sharing provincial revenue with local government.

The tradeoff between infrastructure funding and unconditional grants needs to be carefully considered. Continued funding of infrastructure from revenue sharing is suggested, since revenue sharing represents an assured source of local government funding. Recent evidence shows that revenue sharing has the capacity to fund both substantial infrastructure grants and unconditional grants.

The Ministry believes an allocation of 50 per cent of total transfers to unconditional grants is an achievable target. In recognition of differences in municipal costs and revenue-raising ability, a technical paper will be prepared on this subject for discussion with a committee with representatives from the Union of British Columbia Municipalities, the Municipal Officers Association and the Government Finance Officers Association.

However, there does not appear to be a need to make wholesale changes to British Columbia's provincial-municipal revenue sharing programs. In particular, the level of grants appears to have kept pace with economic growth following this year's 22 per cent increase in fund transfers.The Ministry is committed to taking advice from the Union of B.C. Municipalities on revenue sharing.

New Directions for Local Government Finance:

THE NEXT STEPS

REVENUE SHARING

PART 2

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British Columbia

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1. OVERVIEW

The Province participates in the financing of local governments through various revenue sharing programs.

The Province participates in the financing of local government through revenue sharing to:

supplement the narrow local revenue base and thereby reduce local dependence on the property tax;

reduce large disparities in the capacity of local governments to finance services; and,

encourage local delivery of services that provide benefits beyond local boundaries.

The first purpose - supplementing the local revenue base and thereby reducing municipal dependence on property taxation - is achieved mainly through unconditional per capita grants. Basic grants and regional district grants are also used to achieve this purpose. These grants account for about $118 million of the $338 million to be disbursed through revenue sharing in 1990/91.

The second purpose - reducing disparities among local governments - is accomplished through the equalized portion of unconditional grants and police and public health equalization grants. In 1990/91 these grants are estimated at $40 million.

The third purpose - encouraging the local delivery of services that have benefits beyond local boundaries - is accomplished through a wide range of conditional grants directed primarily at infrastructure funding. In 1990/91 these grants are estimated at $180 million with about $170 million of that amount to be used for infrastructure funding.

In addition, two revenue sharing special accounts are available to stabilize municipal finances. The Revenue Sharing Stabilization Account acts a cushion against possible reductions in revenue sharing grants during periods of slow economic growth. The Local Government Emergency Account is available to stabilize municipal finances in the case of natural or local economic emergencies.

2. BACKGROUND

2.1 Payments Into the Revenue Sharing Fund

Part 2 describes the source of payments into the Revenue Sharing Fund and types of disbursements from the Fund.

Payments into the fund consist of:

1% of the provincial personal income tax base;

1% of the provincial corporate income tax base; and,

6% of provincial revenue from the social service (sales) tax, fuel tax and land, forest, oil, gas, mining and water royalties.

Table 1 shows the contribution made to revenue sharing in 1990/91 from each revenue source.

Payments into the Fund are based on estimates of provincial revenue. Differences between estimated and actual revenues can be substantial, requiring subsequent year adjustments.

Payments into the fund are based on estimates of provincial revenue. Adjustments are then made in subsequent years to reconcile the estimated figure to actual revenues received. Adjustments for sales tax, fuel tax and resource revenues are made two years after the original estimate when final provincial public accounts figures are available. Adjustments for personal and corporate income tax occur four years after the original estimates have been made, when final figures on the size of the provincial income tax bases are available from the federal government.

Differences between estimated and actual revenues can be substantial. As a result there can be significant differences between revenue sharing entitlements (meaning amounts based on current year revenue estimates) and revenue sharing transfers (meaning actual payments into the Fund after adjustments).

Table 1

MUNICIPAL REVENUE SHARING CALCULATION - 1990/91

	PROVINCIAL	REVENUE SHARING FUND	
	Amount	Entitlement	Amount
	($ Million)	(%)	($ Million)
PERSONAL INCOME TAX BASE	6,637.2	1	66.4
CORPORATE INCOME TAX BASE	5,024.7	1	50.2
OTHER SHAREABLE REVENUE			
Social Service Tax	2,117.0	6	127.0
Fuel Tax	605.0	6	36.3
Land Lease Rental and Fees	49.0	6	2.9
Petroleum and Natural Gas Permits, Fees and Royalties	229.0	6	13.7
Mining Taxes and Royalties	83.0	6	5.0
Timber Sales, Leases, Licences and Royalties and Logging Tax	478.1	6	28.7
Water Rentals	248.0	6	14.9
TOTAL OTHER SHAREABLE REVENUE	3,809.1		228.5
REVENUE SHARING ENTITLEMENT			345.1
ADJUSTMENT FOR PRIOR YEARS			6.8
TOTAL FORECAST TRANSFER			351.9

Fig. 1

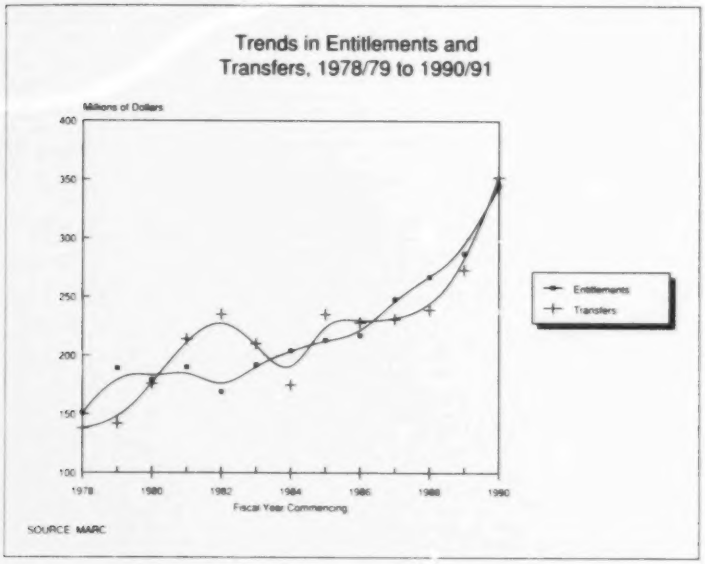


Figure 1 illustrates the relationship between entitlements and payments into the Fund during the 1978/79 to 1990/91 period.

2.2 Payments Out of the Revenue Sharing Fund

Payments out of the Revenue Sharing Fund supplement the local revenue base, reduce disparities among communities and encourage the delivery of local services where these services have benefits beyond local boundaries. This is accomplished through a number of grant programs. Table 2 provides a history of grant payments to local governments.

Payments out of the Revenue Sharing Fund are accomplished through a number of grant programs.

2.2.1 Supplementing the Local Revenue Base

The local revenue base is supplemented by transfers of funds to municipalities or regional districts without restrictions on how the funds are to be used. The following grants are designed to achieve this purpose:

Table 2

Revenue Sharing Program Expenditures ($ millions)
1978/79 to 1990/91

Part #/Grant Name	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
Basic Municipal	4.20	4.23	4.20	4.23	6.67	6.58	6.34	6.27	6.31	8.09	8.28	10.41	10.80
Water Facilities - old	7.09	8.83	12.74	22.17	20.45	31.92	37.02	39.72	40.08	38.73	35.98	35.51	35.00
- new	--	--	--	--	--	--	0.43	1.97	2.47	3.05	3.23	4.40	30.00
Housing Growth Grant	2.59	10.00	11.45	10.98	6.29	2.47	--	--	--	--	--	--	--
MIG	6.71	2.81	1.19	0.36	0.79	--	--	--	--	--	--	--	--
Municipal Highways	3.60	5.22	7.24	11.85	13.36	12.53	11.00	5.36	5.69	8.98	5.68	11.99	15.00
Planning	0.76	0.89	1.05	1.56	1.15	1.01	0.20	0.62	0.56	1.24	0.89	1.01	3.00
Regional District	2.12	2.10	2.13	1.52	2.23	2.08	1.12	1.27	1.33	2.16	2.08	2.66	3.00
Unconditional	106.10	110.04	132.17	162.29	99.28	100.08	90.04	90.37	95.08	100.00	100.20	110.08	130.00
Accelerated Mobile Home Development	--	--	--	0.10	0.83	0.33	--	--	--	--	--	--	--
Restructure	--	--	--	--	3.43	2.44	1.40	2.60	2.48	2.91	1.88	3.22	4.50
Sewer Facilities - old*	--	--	--	--	38.45	51.24	56.84	60.67	63.11	61.05	57.38	55.75	55.00
- new	--	--	--	--	--	--	0.08	0.90	1.06	1.40	2.40	3.98	35.00
Transmission Lines	--	--	--	--	0.41	0.04	0.01	0.05	0.08	0.37	--	0.10	1.00
Additional Study	--	--	--	--	--	--	0.21	0.22	0.42	0.45	0.34	0.65	1.00
Stabilization **	--	--	--	--	--	--	--	--	--	--	--	--	--
Ind. Police Equalization	--	--	--	--	--	--	--	--	--	--	--	5.36	5.85
Public Health Equalization	--	--	--	--	--	--	--	--	--	--	--	8.56	9.00
Emergency ***	--	--	--	--	--	--	--	--	--	--	--	--	--
TOTAL EXPENDITURE	133.17	144.13	172.17	215.06	210.34	210.72	204.69	210.02	218.67	228.43	218.43	253.68	338.15

TABLE NOTES

* Sewerage assistance was provided from General Revenue until 1981/82; thereafter the assistance has been provided out of the Revenue Sharing Fund. Local government contributions to social assistance costs also terminated in 1981/82.

** The balance in the Stabilization Account as of June 4, 1990 was $31,250,000. Transfers from the vote into this account were made in 1985/86 ($25M), 1986/87 ($3.9M), 1987/88 ($250,000), 1988/89 (NIL), 1989/90 ($2.1M) and 1990/91 (proposed $3.75M).

*** Local Government Emergency Account: An amount upto $10M may be transferred into this Account in 1990/91.

1989-90 = actual figures as of June 4, 1990.

1990-91 = Budget; these are not actual figures as for other years.

Basic Grants (Part 1 of the *Revenue Sharing Act* Regulations) - Each municipality is entitled to an annual grant of between $50,000 and $100,000 with the actual grant amount determined on the basis of how the average per capita assessment in the municipality compares to that of all municipalities in the Province. Higher amounts flow to municipalities with lower per capita assessments.

Basic Grants, Regional District Grants and part of Unconditional Grants are provided to supplement the local revenue base.

Regional District Grants (Part 7) - Each regional district is entitled to an annual basic grant of $50,000 and an annual administration grant of $50,000 for a total of $100,000. Beginning in 1990, the administration grant is increased by $2,500 for each local community established in the regional district under section 817 of the *Municipal Act*.

Unconditional Grants (Part 8) - The largest share of the Revenue Sharing Fund is distributed under this part. Eighty percent of this amount is distributed on a per capita basis with the other 20% distributed on the basis of an equalization formula (discussed in section 2.2.2). The purpose of these grants is to supplement local own source revenue in order to provide local government access to the broader provincial revenue base and thereby reduce reliance on the property tax.

2.2.2 Reducing Disparities Among Communities

These grants reduce disparities among local governments. Such disparities primarily relate to differences in local revenue raising capacity. However, through the independent police and public health equalization grant programs, differences in service delivery patterns are also addressed.

Equalized Unconditional Grants (Part 8) Twenty percent of unconditional grants are distributed on the basis of a formula that involves average assessments and expenditures as surrogates for local government need and financial capacity. In 1990/91 these grants are estimated at $26 million. Basic and Regional District grants also support this purpose.

Independent Police Equalization Grant (Part 15) - This grant enables the Province to share the costs of policing with the 12 municipalities which support independent police forces. The grant formula is the lesser of the cost of policing the first 5000 people in the community, or the amount that would be paid by the federal government under the RCMP contract if the

Part of Unconditional Grants, the Police Grant and Health Grant are aimed at reducing disparities between communities.

community were a RCMP contract municipality. In practice, smaller communities receive the contract equivalent and larger communities receive the cost of policing the first 5000 people. In 1990/91 grants are estimated at $5.85 million.

Public Health Equalization Grant (Part 16) - These grants enable the Province to share the costs of providing public health services in Burnaby, New Westminster, Richmond, Vancouver and municipalities served by the North Shore Union Board of Health. Elsewhere, this is usually a provincial responsibility. The grant formula is the total shareable cost base multiplied by the provincial share of the cost base, less any Ministry of Health contributions. In 1990/91 these grants are estimated to be $9 million.

2.2.3 Encouraging the Delivery of Services that Have Benefits Beyond Local Boundaries

Most of the grants in this category fund the capital cost of water facilities, municipal highways, sewage collection and disposal facilities and installation of underground transmission lines. Grants to encourage various types of planning activities and an efficient local government structure are also provided.

Water Facilities (Part 2) - The present program provides for 25% to 50% funding of the capital cost of approved projects.

Assistance approved under the original program is also continuing. That program provided funding for 75% of annual debt charges in excess of the product of an annual levy of a mill rate prescribed by the Minister on the net taxable value of land and improvements. New debt incurred after July 31, 1983 is ineligible for funding under the original program.

The 1990/91 budget amount for the old program is $35 million and $30 million for the new program.

The Water Facilities Grant, Municipal Highway Grant, Sewerage Assistance and other types of grants encourage the delivery of services that have benefits beyond local boundaries.

Municipal Highway Grant (Part 5) - A municipality undertaking construction of major municipal highways may qualify for a grant of up to 50% of approved shareable costs. The 1990/91 budget amount for these grants is $15 million.

Sewerage Assistance (Part 11) - The present program generally provides for 25% to 50% funding of the capital cost of approved projects.

Assistance approved under the original program is also continuing. That program provided funding for 75% of annual debt charges in excess of the product of an annual levy of a mill rate prescribed by the Minister on the net taxable value of land and improvements. New debt incurred after July 31, 1983 is ineligible for funding under the original program.

The 1990/91 budget amount for the old program is $55 million and $35 million for the new program.

Transmission Line Assistance (Part 12) - On approved projects, the cost of installing an underground transmission line is shared equally among the municipality, the utility company and the Province. The 1990/91 budget amount is $1 million.

Planning Grants (Part 6) - These grants are available to municipalities and regional districts for preparing or implementing official community plans or rural land use bylaws, economic strategy plans, comprehensive planning studies or other approved planning programs. The 1990/91 budget amount is $3 million.

Infrastructure Study Grants (Part 13) - Grants for water and sewer studies are available to municipalities and regional districts. Approved costs for studies are cost shared on the basis of 100% for the first $5,000 and 50% for the next $10,000. The maximum grant for any approved study is $10,000. The 1990/91 budget amount is $1 million.

Restructuring Assistance (Part 10) - Grants are available to municipalities and regional districts to facilitate incorporation, amalgamation, or substantial change in their boundaries. Pre-incorporation grants are primarily for studies and detailed planning of changes. Post-incorporation assistance can include assistance of up to $200 per capita for new municipal population and up to $100 per capita for total municipal population.

2.2.4 Special Accounts

Two revenue sharing special accounts are available to stabilize local government finances. The Revenue Sharing Stabilization Account acts as a cushion against possible reductions in unconditional grants that could result during periods of slow economic growth. The Local Government Emergency Account is available to stabilize municipal finances in the case of natural or local economic emergencies.

The Stabilization Account and Local Government Emergency Account are available to stabilize local government finances.

Stabilization (Part 14) - The purpose of the account is two-fold:

to avoid year to year reductions in unconditional grants; and

to ensure sufficient funds are available to meet prior year commitments under the service subsidy programs.

Currently there is $31.25 million in the fund. As of March 31, 1991 the balance is expected to be $35 million. Beginning in 1990/91 interest accruing on the account is credited to the Revenue Sharing Fund.

Local Government Emergency Account - This account was created in 1990. It will be used to help local governments through difficult times by assisting local governments through economic or natural emergencies or periods of significant institutional change. The current balance in the account is $10 million, with interest accruing to the Revenue Sharing Fund.

3. *FINANCING LOCAL GOVERNMENT* RECOMMENDATIONS

Financing Local Government made a number of recommendations regarding the future of revenue sharing. As a general statement the study recommended that the original purposes of revenue sharing be endorsed and that the Revenue Sharing Fund be maintained as the administrative mechanism for revenue sharing[1]. It also made specific recommendations related to the basis of payments into and out of the fund.

3.1 Recommendations Concerning Payments Into the Fund

In regard to payments made into the fund, the key recommendation of the study was:

> The revenue sharing formula be changed to ensure substantially better tracking of provincial revenue growth[2].

Financing Local Government made a number of recommendations regarding the Revenue Sharing Fund and associated programs.

3.2 Recommendations Concerning Payments Out of the Fund

The study contained the following major recommendations concerning payments out of the fund:

> Growth in unconditional grants should be assured by allocating at least 50% of annual Revenue Sharing Funds to this component[3].
>
> The allocation formula for unconditional grants should remain substantially unchanged with the majority of transfers allocated on a per capita basis. However, work should continue to develop more acceptable indices of relative cost and ability to pay[4].
>
> The new sewerage assistance program should be removed from revenue sharing[5]; and,
>
> The stabilization account should be retained as a "rainy-day" account and capped at 10% of annual revenue sharing transfers. Interest on the balance in the stabilization account should be credited to the Revenue Sharing Fund. The account should be drawn down where the funds allocated to unconditional grants would otherwise be below those allocated in the previous year[6].

In general, these recommendations indicate that it is important that the Revenue Sharing Fund grow at approximately the same rate as provincial revenue and that most of the funds be allocated on an unconditional basis with this unconditional allocation shielded from both increased demands for improved sewage facilities and declines in provincial revenues.

4. DISCUSSION OF *LOCAL GOVERNMENT* RECOMMENDATIONS

The following discussion will address the recommendations made in *Financing Local Government* and provide a basis for discussion of possible future directions in revenue sharing.

This section addresses the *Financing Local Government Study* recommendations.

In general, the discussion concerns two issues. These are:

- the amount of provincial revenue allocated to the fund; and,
- the allocation of this revenue among the various purposes and programs of the fund and among various municipalities.

4.1 Payments Into the Fund

4.1.1 Overall Growth in Revenue Sharing

Financing Local Government recommended that the revenue sharing formula be changed to ensure better tracking of growth in provincial revenue and the provincial economy[2].

This recommendation was based on a twelve year (1978/79-1989/90) analysis which found that:

- the 6.4% average annual growth of payments into the fund had kept pace with the average 6.2% inflation rate but not the average annual 8.6% increase in provincial revenue and the provincial economy; and,
- the pattern of revenue sharing growth was subject to larger fluctuations then growth in overall provincial revenue.

The study concluded that better tracking could be most effectively accomplished by tying the formula to provincial revenue sources that mirror economic performance and which reflect the composition of provincial revenue. It indicated that such a change would have cost the Province $86 million in 1989/90[7].

In considering this issue three questions need to be faced. The first is the priority attached to particular *Financing Local Government* recommendations, given the provincial need to consider the overall cost of each recommendation in the context of other competing demands for provincial funds and general taxpayer concern about the overall level of taxation. The second is the effect of the 22% increase in 1990/91 revenue sharing payments on the *Financing Local Government* conclusions. The third is whether revenue sharing growth should reflect growth in provincial spending when that spending exceeds growth in the economy.

Provincial Ability to Pay

In addition to the recommendation to enhance revenue sharing, *Financing Local Government* recommended substantial changes in school financing[v] and provincial payment of taxes on all provincial property[vi]. The 1990 provincial response to the recommendations on school financing cost an estimated $450 million. Complete payment of property taxes on all provincial property has a cost of over $100 million.

Commitments to increased provincial expenditures will have to be made taking into consideration the provincial ability to pay and the priority which local government attaches to particular types of transfers.

Commitments to increased provincial expenditures must take into account provincial ability to pay and local government priorities regarding types of transfers.

Impact of 1990/91 Revenue Sharing Increase on Results of FLG Analysis

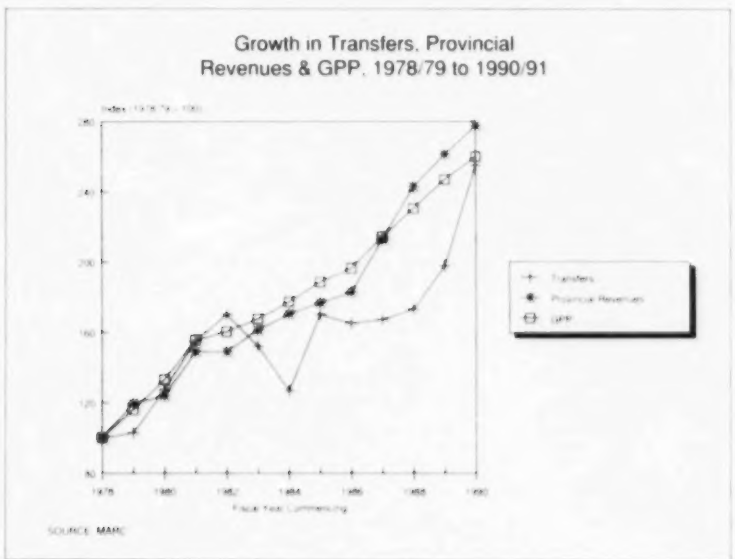
Since the *Financing Local Government* analysis was completed payments into the Revenue Sharing Fund have increased by 22%. This large increase reflects the fact that 1989/90 revenue sharing payments included significant negative prior year adjustments in respect of previous years and were based on estimates of provincial revenue that were lower than the revenue actually received. In order to reflect the current situation the results of an updated analysis are shown in figure 2.

The updated analysis indicates that there is a much closer overall relationship between the growth of the Revenue Sharing Fund and both economic growth and provincial revenue. On the basis of the updated figures, payments into the fund grew at an average annual rate of 8.12%

Growth in the Revenue Sharing Fund mirrors growth in both provincial revenue and the provincial economy.

compared to average annual growth of 8.28% for the economy and 8.87% for provincial revenue. As a result the difference between the current level of revenue sharing and what it would be if it had perfectly tracked economic growth or growth in provincial revenue is now $6 and $30 million respectively. This is substantially less than the $86 million gap noted in *Financing Local Government*. The existing rate of growth in revenue sharing is also significantly larger than the 6.1% rate of inflation over the period.

Fig. 2



When Provincial Revenue Grows Faster Than the Economy

There are sound reasons for arguing that payments into the Revenue Sharing Fund should bear a reasonable relationship to growth in the provincial economy. Economic growth mirrors a range of changes such as population growth, urban development and industrial development that have substantial impacts on municipal costs. The updated figures indicate that the current formula has achieved that goal reasonably effectively.

Payments into the Revenue Sharing Fund should bear a reasonable relationship to growth in the provincial economy but should not be tied, in a fixed proportion, to provincial revenues or expenditures.

The arguments for requiring the fund to grow at the same rate as provincial revenues are less convincing. Changes to provincial revenue reflect not only

economic growth but also the demand for provincial services. That is to say overall growth in revenue is a combination of natural growth in revenue sources and provincial decisions - often difficult ones - to raise tax levels in order to deal with strong increases in the cost of a particular service area. It is not clear that such increases should be reflected in revenue sharing.

For example, since 1978/79 provincial expenditure patterns in British Columbia and virtually every other Canadian province have been significantly influenced by the increasing cost of health care. This has tended to crowd-out other expenditures as provinces have struggled to maintain reasonable taxation levels in the context of rising health care costs. Consequently, if all other provincial programs continued to represent the same proportion of overall expenditure as was the case of 1978/79, the overall tax level would be substantially higher.

It is therefore difficult to accept any argument that would fix the cost of any provincial program in terms of its proportion of overall provincial expenditure or revenue. To do so would place too much emphasis on maintaining provincial spending levels and too little on effectively managing overall tax levels.

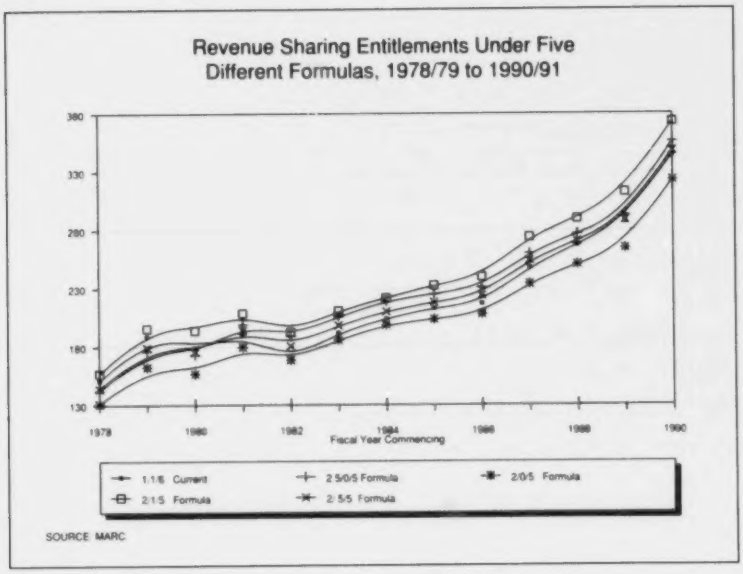
4.1.2 The Pattern of Revenue Sharing Growth

This section deals with the weights of revenue sources in the Revenue Sharing Fund and whether the weights reflect the composition of provincial revenue.

A second *Financing Local Government* concern was that the weighting of the revenue sources which make up revenue sharing do not reflect the composition of provincial revenue.[2] It was suggested that the current formula contained a bias towards the relatively volatile resource and corporate income tax revenues and away from the more stable personal income tax revenue.

The trends shown in figure 2 support the conclusion that revenue sharing is more volatile than are changes in economic growth. The volatility is not due to the entitlement formula. Figure 1 shows that growth in entitlements has been quite steady. As a result changing the entitlement formula will have relatively little effect on the stability of revenue sharing payments. Figure 3 supports this by showing the similarity among the growth patterns of alternative entitlement formulas.

Fig. 3



The figure shows the similarity between the growth patterns of alternative entitlement formulas.

Instead, the volatility appears to be caused largely by the effect of the prior year adjustments used to reconcile estimated entitlements to actual entitlements.

An examination of prior year adjustments reveals several reasons for the substantial difference between original estimated entitlements and final figures. These are difficulties in forecasting resource revenues and the corporate income tax base; and, the impact of changes to the provincial sales tax rate on forecasts of entitlements. Nonetheless, although the differences are substantial, the only time in which payments declined is 1983 — during the very deep recession of the early eighties. In such cases an alternative to changing the formula is to use the existing stabilization account to maintain unconditional grants. This second option for addressing volatility was not fully considered in *Financing Local Government*.

If the goal is to prevent declines in unconditional grants during periods of slow economic growth there is a choice between continued maintenance of the stabilization account and a change in the entitlement formula. There does not appear to be a compelling argument to do both of these things. Since the stabilization account is already in place it may be preferable to maintain it.

4.2 Payments Out of the Fund

4.2.1 Supplementing the Local Revenue Base: Making Unconditional Grants Equal to 50% of Revenue Sharing

In 1990/91 $130 million was allocated to unconditional grants. This represented 37% of the total revenue sharing transfer.

The *Financing Local Government Study* recommended that unconditional grants be made equal to 50% of revenue sharing and ultimately increased to 75%.

As a proportion of total revenue sharing grants, the 1990/91 figure is significantly lower than in 1978/79 when unconditional grants represented 80% of payments from revenue sharing. *Financing Local Government* noted this decline and recommended that unconditional grants be made equal to 50% of revenue sharing and ultimately be increased to 75% of total revenue sharing payments[3].

The suggestion is that relatively more reliance should be placed on unconditional grants, which supplement local revenues without creating incentives for local government to spend additional funds on particular services. Such an approach is consistent with the provincial view that local government should have a significant degree of autonomy to deal with local matters and with the goal of reducing local reliance on property tax.

The actual proportion of revenue sharing that should be committed to unconditional grants is a subject for discussion.

Financing Local Government put forward the view that the proportion of the total revenue sharing transfer represented by unconditional grants should be set at 75% because that was similar to the level which prevailed in the early years of revenue sharing.

Further analysis suggests that the 75% figure may in fact be higher than actual allotments during those early years. This is based on the following two observations.

First, the figures in *Financing Local Government*, on the early importance of the unconditional grant program may be somewhat overstated because at that time local governments were required to pay the province part of the cost of social assistance costs. In 1978/79 this represented a transfer of $24.4 million. If the effect of this transfer is ignored, it would overstate the

importance of the unconditional grant program because there was no offsetting grant from local government to the Province. Deducting $24.4 million from the unconditional grants paid under revenue sharing, a reasonable adjustment, the net amount represents 61% of the revenue sharing transfer. In 1982/83 this transfer was eliminated over two years.

Second, the relative decline in unconditional grants is primarily due to the increasing importance of infrastructure grants within revenue sharing. This is partly due to the addition of the Sewerage Assistance Program to revenue sharing 1982. However, it is also due to the fact that debt service programs such as the old water and sewerage assistance programs were very inexpensive at first but grew quickly as new debt was incurred. These high cost levels are not maintained for long periods of time, as debt is paid down. Therefore, even if no changes had been made to revenue sharing, there would have been a decline in the share of unconditional grants as the cost of the old water facilities assistance program grew.

Given these two observations the validity of the 75% target set by *Financing Local Government* may be in question. However, a 50% target could be achieved by allocating future growth in the fund to unconditional grants. If revenue sharing were to grow at a very conservative rate of 5% per year the 50% target would be met within 5 years. More rapid growth in overall transfers could enable the goal to be met more quickly.

50% target could be achieved by allocating future growth in the fund to unconditional grants.

In short, a 50% goal appears to be achievable within five years barring very high levels of demand for infrastructure funding. This question of maintaining and managing infrastructure financing is addressed later in the paper.

4.2.2 Reducing Disparities: Allocating Unconditional Grants Among Municipalities

This section focuses on the formula for the distribution of unconditional grants.

Eighty percent of the unconditional grant is distributed on a simple per capita basis. A municipality with 3% of the total British Columbia municipal population will receive 3% of the funding available under this component. Twenty percent of the unconditional grant is distributed by the proportion of weighted municipal expenditure to the total weighted expenditures of all

B.C. municipalities. Hence, a municipality with 3% of the total municipal weighted expenditures will receive 3% of the funding under this component. Expenditures are weighted using a measure of relative per capita assessment.

Basic grants are distributed according to a similar principle. Each municipality receives a basic amount of $50,000 and municipalities with relatively low per capita tax bases receive an additional amount of up to $50,000.

The distribution of a portion of the unconditional grant on a weighted expenditure basis is done to provide municipalities that have larger spending requirements, due to factors such as high snowfall or less ability to pay due to relatively poor tax bases, with additional amounts in order to reduce these disparities.

However, the measurement of the disparities is a difficult issue. For example, although relative expenditure can measure need, it can also reflect the provision of additional discretionary services. Similarly, relatively high assessed values may reflect factors such as high residential values which many argue do not indicate a higher capacity to pay tax.

These questions were discussed during the *Financing Local Government* Study by the revenue sharing working group which reviewed a number of alternative means of achieving equalization. On the basis of this work, *Financing Local Government* recommended that the primary basis for distributing unconditional grants continue to be municipal population and that work continue on the development of more acceptable indices of relative cost and ability to pay with respect to the 20% element of the formula.[4]

In order to follow up on this recommendation the Ministry of Municipal Affairs, Recreation and Culture will, during the next year, complete a technical paper on indices of need and ability to pay and create a joint local/provincial technical committee to discuss the identified alternatives.

There is a need for a technical paper on possible new distribution formulas.

4.2.3 Encouraging the Delivery of Services that Have Benefits Beyond Municipal Boundaries: Should Sewerage Assistance be Funded From Revenue Sharing?

Financing Local Government Study recommended the removal of the sewerage assistance program from revenue sharing.

Financing Local Government recommended the removal of the sewerage assistance program from revenue sharing[5]. This recommendation was partially based on:

> the view that the cost of the program is largely driven by environmental standards controlled by the provincial and federal governments and therefore provincial grants towards it should not compete with the unconditional program; and,
>
> concern that rapid future growth in demand for improvements to sewer infrastructure would displace unconditional funding.

The relationship between the Province's dual roles of determiner of environmental standards and provider of sewerage assistance raises interesting issues concerning the purposes of these two areas of provincial policy.

The purpose of environmental regulation is to establish standards for the maintenance of a clean environment. These standards apply to the discharge of all pollutants into the air, water or soil. Their function is to require polluters to recognize the true cost of their activities and to encourage them to adjust their operations to meet these standards. In the event that the cost of meeting the standards increases the cost of the products produced by the enterprise, the change in the price of the product may influence customer purchasing behaviour in ways that are consistent with the goals of the standards.

Regulatory standards and discharge fees affect the cost of municipal sewer systems.

However, regulatory standards are a very blunt instrument to encourage responsible use of the environment and if not used cautiously can have significant adverse economic consequences. Therefore, they may usefully be supplemented by other measures such as discharge fees, that provide a more sensitive means of reducing the impact of human activity on the environment. In addition, regulators must be sensitive to the impact which their actions have on these being regulated.

Applied to a municipal context, both standards and discharge fees affect the cost of municipal sewer systems, thereby initially forcing municipalities to assume their cost. However, standards and fees are most effective when they are passed directly back to the originator of the sewer discharge because only then do the standards and fees impact the behaviour which creates the discharge.

Since the benefits of higher standards of sewage treatment, for example enhanced water quality, are not confined to the jurisdictions that pay for treatment, individual jurisdictions may be inclined to undersupply such services. This is sometimes referred to as the "spillover effect." The problem is that the demand for service by external beneficiaries is not reflected accurately in servicing decisions. In such situations it may not be appropriate for local residents to pay all of the costs associated with such projects. This question is partially dealt with through the regional district system, which enables local governments to work together to finance programs that deal with issues at a regional level. In addition the Province provides infrastructure assistance to further compensate for such spillovers. Such assistance could ideally be supplemented by federal financial support for improvements to environmental infrastructure. However, such support has not been forthcoming.

The key issues raised in *Financing Local Government* are whether provincial funding should come from revenue sharing or from provincial general revenue and what the appropriate funding level should be.

Removing sewerage assistance from revenue sharing means that the existing trade-off between infrastructure funding and unconditional grants that is central to the allocation of revenue sharing, would be diminished. Sewerage assistance will then have to compete with hospital, school, social assistance and highway costs for funding, in contrast to unconditional grants funding. Given that the purpose of such funding is very similar to that of water facilities assistance and municipal road assistance the advantages of such a realignment are not clear.

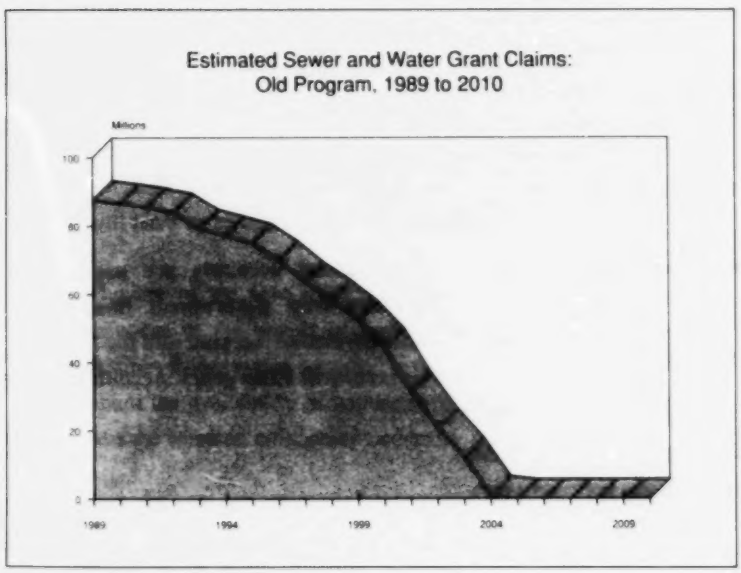
Furthermore, it should be possible to fund sewerage assistance and other infrastructure programs at appropriate levels through revenue sharing while still achieving the goal of making unconditional grants equal to 50% of the total revenue sharing transfers. This is because a substantial portion of

There is a trade off between infrastructure funding and the proportion of revenue sharing distributed as unconditional grants.

existing infrastructure spending is being used to pay the cost of servicing old debt incurred to finance facilities built prior to 1984. At the same time, new projects are being supported through up-front grants of 25% to 50% of their capital costs. As the amount of old debt service grants declines, significant funds will be made available to fund new infrastructure projects.

Figure 4 shows how grant payments under the old program are expected to decline. This decline, together with the substantial increases to sewer and water program funding over the past two years, provides a substantial, increasing block of funding that can be dedicated to infrastructure finance over the next ten years.

Fig. 4



Payments under the old sewer and water programs are expected to decline as shown in the figure, increasing the block of funding available for other revenue sharing purposes.

Over this period an estimated $1 billion could be provided from the fund for the purpose of new infrastructure construction while still allowing unconditional grants to grow to 50% of the total transfer within 5 years. Since the program funds between 25% and 50% of project costs this would fund between $1.5 and $3.0 billion in new infrastructure over the next 10 years.

The actual annual allocation of funds between unconditional and infrastructure grants will depend on the demand for infrastructure funding.

In the short term, placing emphasis on the completion of high cost infrastructure projects may slow the rate at which unconditional grants are increased to 50% of total revenue sharing expenditures. Alternatively, it may be necessary to consider supplementary support from revenue sharing with additional support from general revenue. Such action has previously been taken with respect to pollution control in the Okanagan. The Province will monitor this situation carefully.

In any event, for the polluter pay principle to be effectively applied, increased emphasis will need to be placed on municipal pricing of discharges into the municipal sewage system. This will require the development of appropriate municipal pricing schemes that put more of the cost of pollution abatement back on the originator of the discharge. This is a difficult and complex matter. Therefore, a provincial-municipal technical committee will be struck to examine this issue.

4.2.4 Use of the Stabilization Account

Two special accounts are used to stabilize local government finances, the Stabiliztion Account and the Local Government Emergency Account.

Financing Local Government made several recommendations concerning the Stabilization Account[6]. It recommended that:

> the Stabilization Account be retained as a "rainy-day" account;
>
> the prime objective of the account should be a source of supplemental funding for the unconditional grants if such funds would otherwise fall below those allocated in the previous year; and,
>
> interest on the balance be credited to the Revenue Sharing Fund.

The government has already acted on the matter. It has agreed to pay interest on the Stabilization Account and on the newly created Municipal Emergency Account. This new revenue of $3 to $5 million annually will be used to fund increases to revenue sharing programs.

The account will also continue to be used to ensure that sufficient funds are available to meet prior year commitments for infrastructure support.

4.2.5 Use of the Municipal Emergency Account

Guidelines are being developed for the Local Government Emergency Account.

The Municipal Emergency Account is a new program within revenue sharing and therefore was not considered by the *Financing Local Government Study*.

The new account is to be used to help individual local government units - municipalities or regional districts - through difficult times. It will complement, not duplicate, assistance available to individuals through the Provincial Emergency Program and other programs.

The following proposals represent possible specific uses of the new $10 million allocation.

1. Dealing with the impact on local governments of unanticipated events such as a plant closure, default on property tax payments by major industry or loss of local infrastructure. Since the circumstances and effects of such events cannot be predicted, these will have to be considered on a case by case basis.

   The use of the new account in this way will facilitate a timely response to the impact of such events on local government, as distinct from private persons. In this way it will eliminate doubt about the availability of contingency funds that always seems to surface when an emergency occurs.

2. Providing for transitional assistance to municipalities that are negatively affected by institutional change. A current example is the emergence of native Indian bands as users of the property tax system. In such cases the new account could be used to provide for a more gradual change from the old to the new structure.

3. Providing assistance to municipalities adversely and significantly impacted by losses of tax base due to assessment appeals. Use of the account in this way could act as a substitute for the guaranteed assessment roll put forward by *Financing Local Government*.

The question of how to finance losses due to assessment appeals is an important one.

The question of how to finance losses due to assessment appeals can be approached from two perspectives.

The first perspective emphasizes that final assessments are not arrived at until the appeal process is fully concluded and that local taxes raised by taxing this value have been used to support community services. It therefore concludes that any tax refunds that flow from the removal of such value from the tax base should be received from the community. Under this approach provincial involvement would be limited to making loans to municipalities to ease any cash flow problems associated with the payment of refunds.

The second perspective emphasizes that local government should be able to impose tax rates on a reasonably firm tax base. Under this approach the Province, as the level of government that is responsible for assessing property, would also assume responsibility for product quality by ensuring that the assessments would not change by more than a predetermined amount. Under this option, refunds beyond a fixed amount would be paid from a province-wide fund.

The most difficult issue associated with the guaranteed assessment proposal is related to the financing of the fund. Financing such a fund through an additional property tax has been criticized as an unjustified shift of taxation between jurisdictions. An alternative is to use revenue sharing for this purpose. Consistent with the FLG recommendation that the Province consult with local government before adding new programs to revenue sharing, this idea is put forward for discussion.

4.3 In Conclusion

Revenue sharing transfers serve three purposes. They supplement the local tax base, reduce disparities among local governments and support the provision of services that have benefits beyond municipal boundaries. In this way they reduce local reliance on property taxation.

This paper suggests that these goals have been and will continue to be effectively achieved through the existing revenue sharing structure.

Change is needed in some areas. In particular there is a need to examine the way in which disparities among municipalities are equalized. This will be undertaken by a joint provincial-municipal technical committee.

Other areas require clarification. To this end the paper commits the government to more clearly define the operation of the Revenue Sharing Stabilization Account.

Yet other areas will require on-going discussion. The question of the trade-off between infrastructure funding and unconditional grants is one example.

However, there does not appear to be a need to make wholesale changes. In particular, the level of grants appears to have kept pace with economic growth following the year's 22% increase in fund transfers.

NOTES

All references to notes refer to *Financing Local Government*, a report sponsored by the Ministry of Municipal Affairs, Recreation and Culture, and the Union of British Columbia Municipalities (August 1989).

1. *Financing Local Government*, p. 5.
2. *Financing Local Government*, p. 8.
3. *Financing Local Government*, p. 11.
4. *Financing Local Government*, p. 14.
5. *Financing Local Government*, p. 10.
6. *Financing Local Government*, p. 12.
7. *Financing Local Government*, p. 7.
8. *Financing Local Government*, p. 36–38.
9. *Financing Local Government*, p. 42–43.